United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ORIGINAL

74-2382

To Be Argued by
HERMAN E. COOPER

B

P/S

United States Court of Appeals

FOR THE SECOND CIRCUIT

JAMES M. MORRISSEY, JOSEPH PADILLA, RALPH IBRAHIM, individually and on behalf of the members of the National Maritime Union of America,

Plaintiffs-Appellees-Appellants,

—against—

JOSEPH CURRAN, SHANNON WALL, WILLIAM PERRY, ABRAHAM E. FREEDMAN, MARTIN SEGAL and LEON KARCHMER,

Defendants-Appellants-Appellees.

On Appeal From the United States District Court For the Southern District of New York

BRIEF OF DEFENDANT-APPELLANT-APPELLEE, LEON KARCHMER

HERMAN E. COOPER
Attorney for Leon Karchmer,
Defendant-Appellant-Appellee,
500 Fifth Avenue
New York, N. Y. 10036

Of Counsel:
STEPHEN GILLERS

TABLE OF CONTENTS

TABLE OF CASES

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- x

JAMES M. MORRISSEY, JOSEPH PADILLA, RALPH IBRAHIM, individually and on behalf of the members of the National Maritime Union of America,

Plaintiffs-Appellees-Appellants,

-against-

JOSEPH CURRAN, SHANNON WALL, WILLIAM PERRY, ABRAHAM E. FREEDMAN, MARTIN SEGAL and LEON KARCHMER,

Defendants-Appellants-Appellees.

- x

PRELIMINARY STATEMENT

These are appeals and cross-appeals from decisions of Hon. Dudley B. Bonsal, as yet unreported.

ISSUES PRESENTED

Two issues are presented. First, did the District Court properly determine that Leon Karchmer, as a trustee of the NMU Officers' Pension Plan, was culpably negligent in making the Perry payment? Second, is a trustee of a pension plan liable for the attorney's fees expended in

successfully establishing his freedom from willful misconduct and consequent non-liability, under a trust exculpation clause, for an allegedly negligent payment?

STATEMENT OF THE CASE

This case has been here twice before. Originally, plaintiffs brought an action under Section 501 of the Labor Management Reporting and Disclosure Act, 29 U.S.C. § 501, alleging that defendants improperly paid money out of the NMU Officers Pension Plan to National Maritime Union personnel who were not officers and who, therefore, were not covered by the plan. The District Court granted summary judgment to plaintiffs on this claim. Morrissey v. Curran, 302 F. Supp. 32 (S.D.N.Y. 1969). It ordered the defendants to account, enjoined the trustees from paying pension benefits to non-officers, and directed the trustees to transfer from the plan to the union all monies received by the plan for the benefit of non-officers. This Court affirmed the grant of summary judgment on this point. Morrissey v. Curran, 423 F. 2d 393 (2d Cir. 1970).

On remand, the pension plan was ordered to and did transfer to the union $520,283.38, the amount the union contributed to the plan for ineligible employees. In addition, defendant Perry was ordered to repay the plan

$222,200, the amount he, as a non-officer, had improperly received from it. Morrissey v. Curran, 336 F. Supp. 1107 (S.D.N.Y. 1972).

Subsequently, the District Court considered the personal liability of the defendant trustees (Freedman, Segal and Karchmer) to the plan. Morrissey v. Curran, 351 F. Supp. 775 (S.D.N.Y. 1972). The Court concluded that Freedman was guilty of willful misconduct and was liable to the plan for the full amount erroneously paid Perry, but that Segal and Karchmer were not liable for this amount and did not commit willful misconduct. No trustee was held liable for any other payment.

Freedman, a lawyer, was responsible for drafting legal documents for the plan and rendering legal opinions to the other trustees. Segal headed Martin E. Segal & Co., which processed pension applications received from the union, computed benefits and did the actuarial work for the plan. The books of the plan were independently audited. At the last stage, Karchmer, a non-lawyer CPA, received and deposited contributions from the union, reviewed application material and issued checks to the beneficiaries. (351 F. Supp. at 778; App. I 706a, 709a-10a.*)

---

*There are two appendices on this appeal. "App. I" refers to the appendix before the court on the last appeal. "App. II" refers to the supplemental appendix printed for this appeal.

At 9:30 a.m. on January 16, 1969, Curran, President of the NMU, fired Perry, his assistant and a plan participant. Perry filed his pension application with the union. On receipt of an application, the NMU provides data on service credit and entitlement to benefits. (App. I 708a.) The NMU did this for Perry. Freedman then gave his legal opinion that the fired Perry was entitled to a lump sum pension benefit through 1974, for which Perry had applied. Segal's company computed the dollar amount due Perry. Sovel, Freedman's law partner, and "two other gentlemen associated with NMU," appeared at Karchmer's office with the pension application, approved by the NMU as accurate, the Segal company computation of the amount of the pension, and Freedman's opinion letter. Karchmer, the final step in the pension payment process, checked the NMU service record and application, relied upon the computation of the Segal company and Freedman's opinion letter and gave Perry a post-dated check for $222,200 - post-dated because the plan's checking account had insufficient funds on hand that day. (351 F. Supp. 780-82; App. I 722a-27a.)

The District Court concluded that Freedman had acted "with reckless indifference to his duty as trustee" and for this willful misconduct surcharged him for the amount paid Perry. (351 F. Supp. at 784.)

However, the court found Karchmer and Segal free of willful misconduct and made certain findings with regard to them as trustees. It held that when they approved the Perry payment, unlike Freedman, neither knew of plaintiffs' challenge to the inclusion in the pension plan of Perry and other non-officers. (351 F. Supp. at 784.) The Court also found that:

> Both Segal and Karchmer relied on, and acted upon, Freedman's opinion in making payment to Perry. While on the facts presented they were negligent in doing so, there is no evidence that they willfully violated their duty as trustees or were guilty of bad faith. [351 F. Supp. at 784.]

Negligence alone, said the Court, was not sufficient to surcharge Segal and Karchmer for the Perry payment. The plan contained the following exculpatory provisions:

> The Trustees . . . shall be protected in relying and acting upon the opinion of legal counsel (including opinion of legal counsel who is . . . a Trustee hereunder) in connection with any matter pertaining to the administration or execution of this Trust Fund. No Trustee shall be liable for any action taken . . . by him unless such act . . . is the result of willful misconduct, nor for the acts of any . . . attorney selected by the Trustees with reasonable care, nor for any act . . . of any other Trustee. [351 F. Supp. at 782.]

This Court, citing the same exculpatory language, and italicizing the second sentence, affirmed the judgments against Freedman and for Segal and Karchmer. Morrissey v. Curran, 483 F. 2d 480 (2d Cir. 1973).

The District Court's conclusion that Segal and Karchmer were negligent in relying on Freedman's advice has never been reviewed here. Until now, no consequences

flowed from this holding and so there was no need to seek review of it. Now, however, the District Court, post final judgment, justifies its assessment of attorney's fees against Segal and Karchmer on its earlier conclusion that they were negligent.

Appellant Karchmer contends, first, that that conclusion was unfounded and, second, that, in any event, he should not have to pay attorney's fees after successfully establishing his non-liability for the Perry payments under an exculpation clause inserted by the union to induce him to be a trustee of its pension plan.

In the opinions below (one on a motion and the other on a motion for reargument), the District Court held, among other things, that Segal and Karchmer must repay the plan for the time their attorneys spent in establishing that they should not be surcharged for the Perry payment, fixed at 39% of the total fee paid. Although Segal and Karchmer were successful here, the District Court considered that since it was their own negligence that gave rise to the Perry portion of the litigation, they should pay counsel fees allocable to that portion, despite the exculpation provisions. (A. II 147a et seq.) Karchmer argues that on the facts known to him at the time he gave Perry a check, his action was not negligent. Karchmer also argues that given the exculpation clause, even if he is retrospectively found negligent, it would be inconsistent with that clause to charge him for winning.

ARGUMENT

I. Karchmer Was Not Negligent

The District Court's prior holding that Karchmer was negligent in relying on Freedman's opinion has not yet been reviewed by this Court. It takes on sudden importance since the Court below predicates its attorneys fees conclusion on it.

Karchmer argues here that the facts known to him when Perry received his check do not show negligence. When he wrote Perry's check, he was unaware of the legal challenge to Perry's inclusion in the pension plan. Karchmer was the last step in Perry's round of the trustees. Freedman and Segal had already fulfilled their functions. Indeed Freedman, on whom the exculpation clause said Karchmer was entitled to rely, advised Karchmer in writing that Perry had a legal right to the money. Under different facts, a layman's failure to pay in face of counsel's (and co-trustee's) instruction might lead to personal liability. Under these facts, the legal issue of Perry's entitlement had already been determined before it reached Karchmer. Who was Karchmer, a non-lawyer, to second-guess Freedman, the very lawyer whom the Trust Agreement authorized him to follow? We must put ourselves in Karchmer's position. Although a co-trustee, he was functionally a check-writer,

not an actuary or an attorney equipped to make judgments except as to the regularity of the applicant's file before him.

This Court must consider the facts available to Karchmer on the day Perry appeared in his office, with three others, to collect his pension check. The two other trustees had already done their job. Freedman had determined legal entitlement and Segal had determined amount. Documents attesting to these conclusions were delivered to Karchmer. Karchmer had the right to rely on these documents. The Trust Agreement says (App. I 956a):

> 5. The Trustees shall be protected in acting upon any paper or document believed by them to be genuine and to have been made, executed, or delivered by the proper party purporting to have made, executed or delivered the same. . . .

It is entirely unfair to second-guess Karchmer's action in light of the much later decision of the courts that, under the law, Perry was not entitled to the money because he was not an officer of the union.

To what extent does a trustee's reliance on counsel's advice, as permitted and encouraged by the very document that made him a trustee, protect him if the advice goes wrong? It is appropriate to look to state law. Congress intended the federal courts to consider common and state law in their implementation of Section 501. Holdeman v. Sheldon, 204 F. Supp. 890, 895 (S.D.N.Y. 1962) aff'd. 311 F. 2d 2, 3 (2d Cir. 1962). Highway Truck Drivers

and Helpers Local 107 v. Cohen, 182 F. Supp. 608, 617 (E.D. Pa. 1960) aff'd. 284 F. 2d 162 (3rd Cir. 1960).

In New York and elsewhere, reliance on counsel's advice, when allowed by the trust instrument, negates a charge of negligence when sought and followed in good faith as here. Mills v. Bluestein, 275 N.Y. 317, 324 (1937) (Lehman, J.). Dill v. Boston Safe Deposit and Trust Co., 343 Mass. 97, 100-101, 175 N.E. 2d at 911, 913 (1961). In Dill, the settlor gave the trustee express power to rely upon the advice of counsel "concerning any questions . . . in any way relating to the trust fund . . . and in all such matters to act in accordance with the . . . advice." Said the Court: "This is broad language and equates action upon the advice of counsel to action in good faith."

Karchmer relied on Freedman's advice, as he was entitled to do in carrying out his duties, namely verifying the union's service calculation, reviewing the award entitlement and writing checks. Given the union's express authorization to rely on that advice, it is inconsistent now to call such reliance negligent.

The District Court relied on certain findings in holding Karchmer negligent:

> Karchmer was put on inquiry the previous December when he received NMU's check for $41,250.01 for Perry's account, which he thought unusual enough to photostat. He testified that Perry's lump sum payment was the first of its kind and largest ever made by the Officers Pension Plan, and processed faster than any other. Despite this, he delivered a post-dated check to Perry on the day of Perry's application. [351 F. Supp. at 784.]

The fact that Perry's payment was the largest ever or the fastest processed should not alone equal negligence. Someone's check has to be the largest and fastest - is it, ipso facto, negligent to issue it? And the post-dated aspect is entirely reasonable given the insufficient funds in the account that day.

Indeed, the size and speed of Perry's check are not even the reasons it was held invalid. It was held invalid because Perry was determined to be a non-officer and the plan covered officers only. Size and speed have nothing to do with this determination.

What then constituted Karchmer's culpable negligence? Could he have known or foreseen that for good faith performance of the activities protected by the Trust Agreement he was risking liability? Could this layman forecast that the Perry payment would long after be found by the court to have been wrongfully made as a matter of law because Perry was a non-officer? He did not even have actual or implied notice of any existing challenge to the payment, as the court found in absolving Karchmer of willful misconduct. Is he, as a trustee, to be held an insurer of the ultimate legality of acts not then perceptibly unlawful?

The speed with which Perry received his check and its amount involve questions of legal entitlement, to which Karchmer could and did defer to Freedman for advice and guidance. Karchmer is an accountant. There is no finding

that his own services or responsibility to the plan were negligently performed. He should not be expected to second-guess a lawyer whose advice he was obliged to credit.

II. A Pension Plan Trustee is Entitled to Counsel Fees for Successfully Establishing his Non-Liability Under an Exculpation Clause of a Trust Agreement.

There are two distinctions to bear in mind. First, this issue normally arises at a different time - at the commencement of the lawsuit, when the plaintiffs seek to stop the defendants from using union funds in their individual defense against charges of malfeasance. Often the courts agree that, at the conclusion of the litigation, the defendants, if cleared, can raise the right to reimbursement. Here, the question happens to come up at the conclusion of the litigation, when the outcome is known. Pension plan funds have already been used to pay counsel fees. The issue is whether the defendants Segal and Karchmer must reimburse the plan for their successful defense.

A second, more substantive difference between this case and those cited below is that this case involves a pension plan trustee charged with negligence toward the trust fund, whereas prior cases have involved union officials charged with breach of fiduciary obligations to

the union itself. This distinction has already been noted by this Court in this very case, as appears below. These two distinctions raised, we turn to the cases.

In the first Cohen appeal, supra, the Third Circuit specifically approved the rule that reimbursement may be accomplished "with propriety" when union officer defendants "are exonerated from any wrongdoing in connection with the handling of union funds. . . ." 284 F. 2d at 164. As it turned out, however, the union officials in Cohen were found guilty of "looting the treasury," for the unsuccessful defense of which they were required to pay their own counsel fees. Highway Truck Drivers and Helpers Local 107 v. Cohen, 334 F. 2d 378, 381 (3rd Cir. 1964).

The Ninth Circuit has also approved the rule of reimbursement under certain circumstances. "[T]he policy of permitting a union to reimburse its officers who have successfully defended themselves against charges of violating § 501 provides adequate protection of union officers from baseless litigation." Kerr v. Shanks, 466 F. 2d 1271, 1277 (9th Cir. 1972).

In this Circuit, the rule has been established that union officers may not be reimbursed their counsel fees if bad faith is established. Holdeman v. Sheldon, 204 F. Supp. 890 (S.D.N.Y. 1962) aff'd. 311 F. 2d 2, 3 (2d Cir. 1962). In Holdeman, this Court said that it would permit a "union to reimburse a defendant if he is successful in his defense, or perhaps even where his actions were based

on a reasonable judgment as to appropriate procedures and do not evidence bad faith. . . ." 311 F. 2d at 3. Accord Koonice v. Gaier, 320 F. Supp. 1321, 1323-24 (S.D.N.Y. 1971) (Judge Weinfeld held that reimbursement is permissible if the defendant's actions were "not inspired by bad faith.")

Here, the District Court has specifically held that Karchmer was not guilty of bad faith or willful misconduct. "[T]here is no evidence that they [Segal and Karchmer] willfully violated their duty as trustees or were guilty of bad faith." (351 F. Supp. at 784.) This Court has specifically affirmed that finding. 483 F. 2d at 483.

This holding and affirmance are in accord with the reasoning of the Court in Dill v. Boston Safe Deposit and Trust Co., supra, which considered the effect of a trust provision, like the one here, allowing the trustee to rely on the advice of counsel. That provision, said the Dill Court, "equates action upon the advice of counsel to action in good faith." (343 Mass. at 100; 175 N.E. 2d at 913.) The District Court here specifically found that "both Segal and Karchmer relied on, and acted upon, Freedman's opinion in making the payment to Perry." (351 F. Supp. at 784.)

In sum, Segal and Karchmer acted in good faith, whether or not negligent, and they are entitled to counsel fees for successfully establishing their own non-liability. A trustee who contests a challenge to the trust instrument, even its exculpation clause, or who contests a challenge

to his conduct as trustee is entitled, if successful, to have counsel fees paid out of the corpus of the trust. In re Bishop's Will, 277 App. Div. 108, 115, 98 N.Y.S. 2d 69 (1st Dept. 1950); Weidlich v. Comley, 267 F. 2d 133, 134 (2d Cir. 1959) (Hand, J.).

If a union officer is entitled to reimbursement for counsel fees should litigation establish that his conduct lacked bad faith, then the good faith trustees of a pension plan, acting within a valid exculpation clause, are in a stronger position to have their counsel fees paid. Judge Hays recognized this distinction when this case was last before the Court. He wrote:

> Neither the express language, the legislative history of the section [501] or the purpose of this section indicate the desire of Congress to include trustee exculpatory provisions within the general ban on exculpatory provisions. The language of this section is clearly aimed at union officers, not trustees; nor can a trust be equated with "a labor organization." The purpose of Congress in enacting Section 501(a) supports this literal interpretation of the provision. The Section was aimed at stopping the pilfering of union funds by union officers, not at the conduct of trustees acting in their capacity as fiduciaries.

Most, if not all, of the cases that have so far concerned the right to counsel fee reimbursement under Section 501, while maintaining that the right exists in the absence of bad faith, have denied it to union officers found guilty of "looting the treasury." In those cases, the union officers had to defend themselves against charges that they stole from the union treasury for their

private gain. Here, this, and, indeed all, "bad faith" has been found absent - this Court had affirmed that finding. The alleged negligent act benefited Karchmer not at all. There has been no looting for personal gain. Given the purpose of Section 501 - to prevent, as Judge Hays says, "the pilfering of union funds by union officers" - and given, further, the exculpation provisions agreed to by the union itself, it was error to assess counsel fees here. In re Cowles' Will, 22 App. Div. 2d 365, 378, 255 N.Y.S. 2d 160, 175 (1st Dept. 1965), aff'd. 17 N.Y. 2d 567, 268 N.Y.S. 2d 327 (1966) ("the exculpation clause relieves the trustee from liability for any surcharge in the abuse of a showing of willful negligence, self-dealing or bad faith on its part.")

If this decision is allowed to stand, we may find ourselves in an anomalous circumstance. Counsel for a Section 501 plaintiff may fail in his attempt to surcharge a pension plan trustee, yet get counsel fees himself from the unbenefited plan because he successfully forced the winning trustee to pay his own lawyer. Never before has the law rewarded a lawyer for bringing a losing action on behalf of a client who gained nothing from his efforts. It should not start now.

CONCLUSION

The judgment of the District Court requiring Leon Karchmer to pay the percentage of his counsel fees attributable to the Perry claim should be reversed.

Respectfully submitted,

HERMAN E. COOPER
Attorney for Defendant,
Leon Karchmer

Of Counsel:

Stephen Gillers

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

JAMES M. MORRISSEY et al,

Plaintiffs-appellees-appellants

--against--

Joseph CURRAN, et al,

Defendants-Appellants Appellees

AFFIDAVIT OF SERVICE

STATE OF NEW YORK,
COUNTY OF NEW YORK, ss:

Bernard Greenberg being duly sworn,

deposes and says that he is over the age of 21 years and resides at 162 East 7th Street New York, N.Y.

That on the 11th day of February, 1975

he served the annexed Brief of defendant-appellant-appellee, Leon Karchmer upon Joint Appendix

Simpson, Thacher & Barlett, Attorneys for Segal, Defendant-Appellant-appellee, One Battery Park Plaza, New York, N.Y. 1004

Duer & Taylor, Attorneys for the Plaintiffs-appellees-appellants, 74 Trinity Place, New York, N.Y. 10006

~~HEXHOXKCX~~

Abraham E. Freedman, 345 West 17th Street, New York, N.Y.

Charles Sovel, 346 West 17th Street, New York, N.Y.

Bromsen, Gammerman, Altier & Wayne, 450 Seventh Avenue, New York, N.Y.